



Faculty of Economics and Business

CAPITAL STRUCTURE AND PROFITABILITY IN MALAYSIAN PLANTATION SECTOR

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**CAPITAL STRUCTURE AND PROFITABILITY IN MALAYSIAN
PLANTATION SECTOR**

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Statement of Originality

The work described in this Final Year Project, entitled
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is to the best of the author’s knowledge that of the author except
where due reference is made.

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ABSTRACT

CAPITAL STRUCTURE AND PROFITABILITY IN MALAYSIAN PLANTATION SECTOR

By

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This purpose of this study is to examine the relationship between the capital structure and profitability of 21 plantation companies which listed in Bursa Malaysia during the years 2009 to 2013. The dependent variable is firms' profitability, measured by Return on assets (ROA). Independent variables in this study include Debt to assets ratio (DAR), Debt to equity ratio (DER), Firms' growth (G), Liquidity (LQ), Assets tangibility (TANG) and Degree of operating leverage (DOL). Panel data regression analysis is utilized to analyze on the findings of the study. The result shows that Debt to equity ratio (DER) and Degree of operating leverage (DOL) are positive and significantly related to ROA, while Debt to assets ratio (DAR), Firms' growth (G), Liquidity (LQ) and Assets tangibility (TANG) are found to be negative and significantly related to ROA.

ABSTRAK

STRUKTUR MODAL DAN KEUNTUNGAN DALAM SEKTOR PERLADANGAN Malaysia

Oleh

Sek Wen Jie

Kajian ini bertujuan untuk mengkaji hubungan antara struktur modal dan keuntungan 21 syarikat perladangan yang disenaraikan di Bursa Malaysia bagi tempoh 5 tahun dari 2009 hingga 2013. Pembolehubah bersandar adalah keuntungan syarikat, diukur oleh Pulangan atas aset (ROA). Pembolehubah bebas dalam kajian ini termasuk nisbah hutang kepada aset (DAR), nisbah hutang kepada ekuiti (DER), pertumbuhan firma (G), kecairan (TK), keketaraan aset (TANG) dan ijazah beroperasi leverage (DOL). Panel analisis regresi data adalah digunakan untuk menganalisis dapatan kajian. Hasil kajian ini menunjukkan bahawa nisbah hutang kepada ekuiti (DER) dan ijazah beroperasi leverage (DOL) adalah positif dan signifikan dengan ROA, manakala nisbah hutang kepada aset (DAR), pertumbuhan firma (G), kecairan (TK) dan keketaraan aset (TANG) didapati negatif dan signifikan dengan ROA.

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CHAPTER 1

INTRODUCTION

1.0 Introduction

In the past few decades, the relationship between firms' capital structure decisions and profitability has been widely examined and investigated by many researchers. This study is aim to examine the relationship between the capital structure and firms' profitability by focusing on plantation firms which listed in Bursa Malaysia.

The countries that have most broadly plantation area in this world are Malaysia, Indonesia and other tropical countries. In recent years, Malaysia is trying to invest heavily in plantation companies. This sector has contributes to Malaysian economic growth because it creates more job opportunities to local and foreign workers. The workers require in this sector is around 62,000 and around 12,000 foreign workers are expected to be employed in Sarawak's plantation sector in the early 2015 (Abas and Koi, 2014).

Therefore, capital structure decision becomes a very important financial decision for plantation companies. Understanding the relationship between capital structure and firm financial performance or profitability can help to improve firms' managing and operation in order to achieve a better financial performance.

This chapter is divided into few sections which consist of background of study, problem statement, objective of study, significance of study, scope of study, operationalized and organization of the study. Section 1.1, background of study explains about the history of the capital structure and plantation sector. Section 1.2,

problem statement is the problems and issues related to the topic. Section 1.3 is the objective of study which will explain the general and specific objective in this study. Section 1.4 is significance of study which describes the importance of this study. Section 1.5 is the scope of this study, section 1.6 is the operationalized of this study and lastly section 1.7 organization of the study is the lists of subsections that will be explained in each chapter.

1.1 Background of Study

1.1.1 Capital Structure

Financing decision is the main concerns in both small and large firms because different financing decisions will result into diverse firm's capital structures which may have different influence on the firm's financial performance and profitability. The major objective of a firm's financial decisions is to maximize the wealth of shareholders by increase the value of companies' shares or the stocks' price. Therefore, the capital structure decision of a firm is very important since a poor capital structure decision may affect a firm's performance and profitability leading to a decrease in shareholders' value and firm's survival in the market.

Capital structure decision is a major financial decision of an organization as it is fully related to the risk and return of a organization, shareholders and investor. Capital structure is important on how a firm finances its assets and overall operations and consequently growth by using diverse sources of funds. Capital structure is defined as the mixture or combination of a firm's retained earnings, short-term debt, long-term debt, common equity or share and preferred stock which are employ to

finance its overall growth and enhance its operation (Hasan, Ahsan, Rahaman, & Alam, 2014). Capital structure can be divided into debt capital and equity capital.

Different companies will have different capital structure. The decision of capital structure includes the choice of combination of different sources of funds in a business firm. According to Kipesha and James (2014), most of the companies start with the use of owners' equity or internal source to finance their firm's investments and business, as the company growth, the use of both debt and equity finance will increase. The sources of finance embrace the use of debt financing (short term debt finance and long term debt) and equity financing (preferred stock and common stock) (Khan, 2012). Therefore, capital structure is a mixture or combination of a company's debts which include both short term and long term, common equity and preferred equity.

The source of finance is divided into internal and external finance source. Firms can acquire funds from either internal or external sources. Internal sources of finance comprise retained earnings whereas external sources embrace of loans from bank or financial institutions, trade credit, issuance of bond, and issuance of equity stock (Mwangi, Makau, & Kosimbei, 2014).

1.1.2 Plantation Sector in Malaysia

As part of agriculture, plantation sector has plays an important role in developing Malaysian structural economy. There is variety of plantation products in Malaysia, such as dry rubber, palm oil, forestry, cocoa, pepper, coffee, tea, sugar cane, and tobacco. Malaysia is the second biggest manufacturer of palm oil in the

world and it also ranked as the largest exporter which focusing on producing rubber and palm oil.

Recently, Malaysia is accounts 39 % of world palm oil production and 44% of world exports (Malaysian Palm Oil Board, 2014). As being one of the biggest producers and largest exporters of palm oil and palm oil products in the world, Malaysia has play an essential role in satisfying the sustainably growing of global need for oils and fats. According to the Malaysian Palm Oil Board (2014), 4.49 million hectares of land in Malaysia is under oil palm cultivation. Nevertheless, producers are move over to palm oil industry lead to the gradually decreased in rubber production over the few years. Moreover, Crude Palm Oil Futures contract (FCPO) is the most active derivative contract in Malaysia. It is the global price benchmark for the palm oil industry (Bursa Malaysia, 2015).

In term of agriculture industry in Malaysia, it was recorded as RM56.9 billion or 4.0 percent growth of GDP in year 2013 (Economic Planning Unit, 2013). Moreover, there are few companies that active in palm oil production and owned the oil palm areas in Malaysia. It can be divided into four major categories which are smallholders, organized smallholder such as FELCRA, FELDA, and RISDA, states and private organizations. Private owners are the largest proportion in Malaysia (Abdullah, Wahid, & Malaysian Palm Oil Board, 2010).

Table 1.1: Malaysia's Exports & Imports

	Exports			Imports	
	2014	2013		2014	2013
Jan	1,367,847	1,635,840		15,782	103,816
Feb	1,351,441	1,398,727		8,259	97,542
Mar	1,245,766	1,536,975		15,140	90,204
Apr	1,268,648	1,455,955		43,059	45,362
May	1,406,918	1,407,784		50,698	47,741
Jun	1,481,750	1,411,218		10,993	31,987
Jul	1,446,060	1,453,937		13,308	50,173
Aug	1,437,512	1,526,394		17,574	7,533
Sep	1,628,103	1,605,567		38,491	19,483
Oct	1,605,401	1,664,743		82,917	22,503
Nov	1,512,951	1,528,281		98,940	14,859
Dec	-	1,507,554		-	24,574
Jan-Dec		18,122,134			555,776

Source: Malaysian Palm Oil Board (MPOB), 2013-2014.

Table 1.1 shows that Malaysia's monthly palm oil export and import in year 2013 and 2014. The total export of Malaysian palm oil for year 2013 is 18,122,134, whereas the import for palm oil is 555,776.

Table 1.2: Value of Malaysian Palm oil Exports to Major Countries

Country	Jan – Nov 2014	Jan – Nov 2013	Change (Vol.)	Change (%)	Jan-Dec 2013
China	2,581,881	3,337,845	(755,964)	(22.65)	3,699,638
Egypt	323,635	420,007	(96,372)	(22.95)	450,634
EU	2,170,606	2,096,198	74,408	3.55	2,336,737
India	2,866,390	2,119,083	747,307	35.27	2,325,363
Japan	472,357	451,438	20,919	4.63	501,152
Pakistan	747,825	1,361,240	(613,415)	(45.06)	1,427,605
Philippines	465,284	174,800	290,484	166.18	206,839
USA	706,666	947,356	(240,690)	(25.41)	1,012,135
Total	10,334,644	10,907,967	(573,323)	(5.26)	11,960,103

Source: Malaysian Palm Oil Board (MPOB), 2013-2014

Table 1.2 shows the major countries that import palm oil from Malaysia in year 2013 and 2014. In year 2013, China is the largest importer of palm oil from

Malaysia. However, India represents the largest importer of palm oil from Malaysia in year 2014.

1.2 Problem Statement

The relationship between capital structure and profitability is one of the most famous finance studies in recent year. Capital structure consists of debt and owner's equity which used by a firm to enhance its operation. When the firm has insufficient resource to making investments on its assets, debt become one of the alternative source or fund for financing investments in order to achieve the desired profit. According to Pontoh and Ilat (2013), the capital structure was changed when the debt is used by the firm and which would consequently influences the company profitability related to its risk of bankruptcy.

Literature review on the relationship between the capital structure and profitability showed that there is either a positive, negative or neutral relationship exists in different sectors and various countries. Some of the previous study discovered that positive relationship exist between capital structure and profitability such as the research conducted by Reza Ebrati, Emadi, Balasang, and Safari (2013); Kipesha and James (2014); Nirajini and Priya (2013). However, Idialu (2013) stated that there was a significant negative relationship between firm's profitability and capital structure. In addition, the study of Khan (2012) and Pontoh and Ilat (2013) revealed that there is a negative association between capital structure and firms' financial performance. Moreover, a mixture research finding also had been showed in the study of Umar, Tanveer, Aslam, and Sajid (2012). According to their study, price earnings ratio is negative associates with current liabilities to total asset while

positive relationship exist between price earnings ratio and long term liabilities to total asset. The relationship between capital structure and profitability is still ambiguous due to facts that difference findings' results are acquired from the previous studies.

In addition, many researchers had conducted the studies about the palm oil or plantation sector focused in developed countries. Unfortunately, they are not focused on the study about the impact of capital structure decision on firms' financial performance or profitability of Malaysian plantation sector. Based on the literature review of previous studies, very limited studies had been done to investigate the relationship between capital structure decision and financial performance of plantation companies in Malaysia. Nevertheless, most of the researchers conducted the studies about the relationship between capital structure and profitability in Malaysian property, construction, consumer and industrial sector. Therefore, a specific research in Malaysian plantation sector is important and need to be conduct.

Furthermore, Malaysia is the largest exporter and second biggest manufacturer of palm oil in the world. Malaysia is accounts 39 % of world palm oil manufacture and 44% of world exports (Malaysian Palm Oil Board, 2014). Besides, Crude Palm Oil Futures contract (FCPO) is the most active derivative contract in Malaysia. It is the global price benchmark for the palm oil industry (Bursa Malaysia, 2015). Malaysian government is given more attention and focus to this sector in recent year because it has higher potential to increase the gross domestic product (GDP). In order to ensure this plantation companies are persisted to provide benefits to the Malaysia, it is essentially to identify the factors that can influence the capital

structure and consequently impact on the profit and financial performance of plantation sector.

This study is contributes to the literature by providing insights on the impact of capital structure on profitability of Malaysian plantation companies and fills the gap in the literature. In addition, through this study, we can identify the relationship between the capital structure and profitability of Malaysian plantation companies and investigate whether this relationship is differs from the relationship being identified from other studies. This study consists of some research questions that need to know when conducting the related topic. The research questions are listed below:

- I. Is there any significant relationship between capital structure and profitability of firm in Malaysia plantation sector?
- II. Do firms' growth (G), liquidity (LQ), asset tangibility ratio (TANG) and degree of operating leverage (DOL) give an impact to the profitability of Malaysian plantation sector?

1.3 Objective of Study

1.3.1 General Objective

The main objective of this study is to investigate the impact of capital structure on firms' profitability.

1.3.2 Specific Objective

The specific objectives of this study include:

- I. To determine relationship between capital structure and profitability of firm in Malaysian plantation sector.

- II. To examine the impact of firms' growth (G) on the profitability of Malaysian plantation sector.
- III. To examine the impact of liquidity (LQ) on the profitability of Malaysian plantation sector.
- IV. To examine the impact of asset tangibility ratio (TANG) on the profitability of Malaysian plantation sector.
- V. To examine the impact of degree of operating leverage (DOL) on the profitability of Malaysian plantation sector.

1.4 Significance of Study

In the previous study, the researches mostly study about the relationship between capital structure and profitability in other sectors. Based on the literature review of previous studies, limited studies had been done in plantation sector. This study is intends to contributes to capital structure research by focusing in Malaysian plantation firms. Since the plantation companies may have different consideration in determining their capital structure choice, thus a specific research in plantation sector is important and needs to be done.

This study is help to provide a better understanding on the impact of capital structure on firms' profitability. Through this research, others researchers, readers and potential investors can further understand about how plantation companies structure their capital which consequently affects the profitability of plantation companies. This study is provides an insight to the potential investor to make a better and most appropriate financing decision for investing.

In addition, this study helps to strengthen firms' decision making on capital choice when running their business. Based on the study, a well manage of capital structure on a firm can minimize the risk of facing high debt and bankruptcy. The findings of this study can encourage plantation companies to make adjustment in business strategy in order to improve its profitability and make a better financial performance in future.

Lastly, this study would analyse the factors that influence and determine capital structure in Malaysian plantation sectors. It assists plantation companies to identify the factor that may have an impact on their capital choice. This study is also provides a view or idea on how to build up the optimal capital structure in Malaysian plantation sector.

1.5 Scope of Study

The scope of this study is to examine the impact of capital structure on the selected firms' profitability. This study is also intends to analyse the factors that affect the capital structure and consequently impact on the firms' profitability. This research will be carry out in Malaysian plantation sector. There are 21 plantation companies are selected out of the 41 plantation companies which listed in Bursa Malaysia. Beside, a time series and cross-sectional data are collected to investigate the capital structure and profitability of the Malaysian plantation sector. Financial data are use as observations for this study during the five years period from 2009 to 2013.

1.6 Operationalized

Variables	Types of variables	Types of scale	Hypothesis Direction
Return on Assets (ROA)	Dependent	Ratio	-
Debt to Assets Ratio (DAR)	Independent	Ratio	Negative
Debt to Equity Ratio (DER)	Independent	Ratio	Negative
Firms' Growth (G)	Control	Ratio	Positive
Liquidity (LQ)	Control	Ratio	Positive
Assets Tangibility Ratio (TANG)	Control	Ratio	Positive
Degree of Operating Leverage (DOL)	Control	Ratio	Positive

1.7 Organization of Study

This study emphasize on the relationship between capital structure and profitability of firm in Malaysian plantation sector. This study is organized and divided into five chapters. Chapter one present the structure and overview of this study which mainly comprise of the background of plantation sector Malaysia, problem statement, objectives of this study, significance of study, opera operationalized and scope of study.

Chapter two is about the literature review and summary of previous related studies that have been done by others researches. In this chapter, there are a brief discussion about theories and difference influence of capital structure on the financial performance or profitability in various sector and countries. This chapter is

divided into four sections which consist of theoretical framework, empirical evidence of previous study, summary table and conclusion remark.

Under chapter three, it is about the methodology section that discuss about the data and varieties method that been use in the study. Likewise to the previous chapters, this chapter is divided into several subsections which include conceptual framework, theoretical framework, research model, data descriptions, data analysis, and empirical testing and research hypothesis.

Chapter four is the finding section which is used to analyse the data and interpret the results. The analysis of findings and data results will be presented in details in this chapter.

Lastly, chapter five is about the conclusion of this study which concludes and summarizes the overall finding or data result and provides suggestion and recommendation for further studies.

CHAPTER 2

LITERATURE REVIEW

2.0 Introduction

This chapter contains a review of the theoretical frameworks and empirical evidence about relationship between capital structure and profitability in different sector in various countries. Different theories of capital structure are present in this chapter which is Modigliani and Miller (MM) Theory, Trade-off Theory, Pecking Order Theory and Agency Cost Theory. Although a lot of previous related researches were conducted, but the empirical results of their study is differ from each other due to the reason that sample from different sector and countries in different sampling period. Therefore, this chapter is also review of previous studies' result related to the impact of capital structure on the firms' profitability as well as reviews the other determinants of capital structure in different countries and different sectors of companies. This literature review has to organize into 4 sections. Section 2.1 will discuss the theoretical framework, empirical result of previous study will explain in section 2.2, section 2.3 is about concluding remarks and last section 2.4 provides the matrix table.

2.1 Theoretical Framework

Based on the previous studies, the association between capital structure and firms' profitability can be explained by some theories propose by researchers. The most common theories are the Modigliani and Miller (MM) Theory, Trade-off Theory, Pecking Order Theory and Agency Cost Theory.